SUPREME COURT, U.S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1725

IRVING BERLIN MUSIC CORPORATION,
Petitioner,

—v.—

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

IRVING BERLIN MUSIC CORPORATION,

Petitioner,

—v.—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner prays that a writ of certiorari be issued to review the judgment and opinion of the United States Court of Claims entered in this proceeding on November 14, 1973, and the Order of the United States Court of Claims entered February 20, 1974, denying Petitioner's Motion to Alter or Amend the Judgment.

Opinion Below

The opinion of the Court of Claims is officially reported at 487 F.2d 540 (Ct. Cl. 1973). The opinion and the order denying Petitioner's motion are set forth herein as Appendix A (1a-21a).

Jurisdiction

The judgment of the United States Court of Claims was rendered on November 14, 1973; judgment was entered on the same date. Within the time permitted, Petitioner filed a Motion to Alter or Amend the Judgment of the United States Court of Claims. By an Order dated and entered February 20, 1974, the Court of Claims denied the Motion. This Petition for Certiorari was filed within ninety days of

that date. Jurisdiction of this Court is invoked under Title 28, United States Code, Section 1255(1).

Questions Presented

The questions presented are:

1. Whether the court below properly granted a motion for summary judgment when, in its decision, it assumed material facts not in the record as to which there are genuine disputes requiring a trial.

2. Whether amounts received by Petitioner as compensation for services rendered as an admitted agent, which compensation is measured by a percentage of the copyright royalties received by the owner of a copyright, were "copyright royalties" to Petitioner within the meaning of Section 543(a)(4) of the Internal Revenue Code of 1954, as amended (herein "Code").

Statute Involved

Set forth in full in Appendix B (22a-23a)

Internal Revenue Code of 1954, as amended, 26 U.S.C., Vol. 6, at 6555-6556 (1970):

Section 543(a)(4)

Statement of Case

Petitioner, Irving Berlin Music Corporation, was organized in 1946 by Irving Berlin, the world-famous composer. It is undisputed that Petitioner is a viable company with substantial economic and business purposes and that it has performed essential business services from its inception.

For its fiscal years ended January 31, 1965 and January 31, 1966, Petitioner received as compensation for services performed on behalf of Mr. Berlin $233,877.67 and $230,565.69, respectively. That compensation was 50 percent of the license fees collected by Petitioner on behalf of Irving Berlin, pursuant to the terms of an agency agreement between them dated January 31, 1960. At no time was the

Petitioner the owner of the copyrights with respect to which it collected fees on behalf of Mr. Berlin, nor did the agreement dated January 31, 1960 confer upon the Petitioner any proprietary right or interest in or with respect to the copyrights relevant to this matter.

In a statutory notice of deficiency dated June 9, 1967, the Internal Revenue Service determined that the compensation paid to Petitioner by Mr. Berlin constituted "copyright royalties" within the meaning of Section 543(a)(4) of the Code, and consequently determined that Petitioner was a personal holding company. Petitioner paid the respective tax assessments, including interest thereon, and timely filed Forms 843, Claim, for its taxable years ending January 31, 1965 and January 31, 1966, claiming a refund of the aforesaid tax payments. The claims were denied by the Internal Revenue Service.

On December 4, 1969, Petitioner filed a Petition with the United States Court of Claims, petitioning for a refund of the taxes and interest and invoking the jurisdiction of the Court of Claims under Title 28, United States Code, Section 1491. Subsequent to the filing of Respondent's Answer and the filing of a partial Stipulation of Facts, Petitioner and Respondent filed cross-motions for summary judgment in this matter. The record before the court below consisted solely of the partial Stipulation of Facts, certain exhibits, and an affidavit in support of Petitioner's motion. By a decision rendered by the Court of Claims on November 14, 1973, Respondent's motion for summary judgment was granted, Petitioner's motion for summary judgment was denied, and Petitioner's petition was dismissed. A timely Motion to Alter or Amend the Judgment of the Court of Claims was filed by Petitioner and dismissed without opinion by an Order dated February 20, 1974.

The decision of the court below was premised upon the conclusions that Mr. Berlin "in his unfettered discretion"

simply labeled Petitioner as an "agent" and labeled Petitioner's 50 percent share of the license fees collected on behalf of Mr. Berlin as "compensation." Based upon those conclusions, the court below held that the Petitioner had received "copyright royalty income" within the meaning of Section 543(a)(4) of the Code, since the definition therein did not require the existence of a proprietary interest in the underlying copyrights, but included amounts "labeled" as compensation which are measured in terms of a percentage of the copyright royalties collected by an agent on behalf of a shareholder for the use of or right to use his copyrights.

REASONS FOR GRANTING THE WRIT

I.

The Decision Below Conflicts With Uniform Judicial Standards and Decisions of this Court as to When Summary Judgment May Properly Be Granted.

Rule 101(d) of the Court of Claims Rules follows the well established legal and constitutional requirement that summary judgment may only be granted if "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *See also Fidelity & Deposit Co. of Maryland* v. *United States, Use of Smoot,* 187 U.S. 315 (1902).

Thus, this Court and other courts have always held that summary judgment is a drastic remedy and should only be granted after the court determines that there is no genuine dispute as to any material fact. In *Palmer* v. *Chamberlin,* 191 F.2d 532, 540 (5th Cir. 1951), the Court stated:

> . . . [B]efore rendering judgment the Court must be satisfied not only that there is no issue as to any material fact, but also that the moving party is entitled

> to a judgment as a matter of law. Where, as in this case, the decision of a question of law by the Court depends upon an inquiry into the surrounding facts and circumstances, the Court should refuse to grant a motion for a summary judgment until the facts and circumstances have been sufficiently developed to enable the Court to be reasonably certain that it is making a correct determination of the question of law.

Similarly, in *Cox* v. *American Fidelity and Casualty Co.*, 249 F.2d 616, 618 (9th Cir. 1957), it was stated:

> When confronted with a motion for summary judgment, the trial judge must determine if there are any material factual issues that should be resolved before the trier of fact. It is not the trial judge's function, under Rule 56, to resolve those issues or to weigh the evidence.

The "purpose of the rule is not to cut litigants off from their right of trial. . . ." *Sartor* v. *Arkansas Gas Corp.*, 321 U.S. 620, 627 (1944). In the *Sartor* case, this Court reversed the Court of Appeals which had affirmed a motion for summary judgment in favor of the defendant where there were triable issues of fact arising out of the evidence, even though the defendant relied in part on a stipulation of facts. *See also Rosen* v. *United States*, 126 F. Supp. 13 (E.D.N.Y. 1954).

Furthermore, as stated by this Court in *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962):

> On summary judgment, the inferences to be drawn from the underlying facts contained in such materials must be viewed in the light most favorable to the party opposing the motion.

As will be seen below, the critical facts in issue in the present case are whether Petitioner's arrangement with Mr. Irving Berlin was a true and bona fide agency, and

whether Petitioner's arrangement was, in fact, identical to all outside music publishers. Those issues of fact necessarily involve a determination of genuine issues of fact, including Mr. Berlin's motive and intention or purpose in creating the agency. This Court has held that summary judgment is inappropriate "where motive and intent played leading roles". *Poller* v. *Columbia Broadcasting System, Inc.*, 368 U.S. 464 (1962).

In the instant case the Court of Claims departed from the established and accepted practice, abused the summary judgment procedure and deprived Petitioner of its day in court as to the merits of material issues of fact which were not stipulated, are in dispute and were assumed or inferred by the court below adversely to Petitioner.

As indicated above, this case was decided on the basis of a *partial* Stipulation of Facts. The Government's counsel, the Commissioner and the court below were all so apprised. As is abundantly clear, however, there is nothing in the record below to support the findings of "fact" upon which the court predicated its decision. This will be shown immediately below.

1. *The "classic royalty scheme".* This phrase, or a phrase comparable thereto, is used at least three times in the opinion below to emphasize that the income Petitioner received would be copyright royalties under a "classic royalty scheme". Yet there is nothing in the Stipulation or by way of evidence to show that all music publishers utilize a "classic royalty scheme" or receive copyright royalty income.

2. *All Music Publishers receive copyright royalty income.* The clear finding and inference in the opinion below is that all outside music publishers receive copyright royalty income in all cases from works of composers with whom they have agreements. From this it is argued repeatedly by the court that Petitioner is in the same position. Yet, there is no evidence in the record as to what any other

specific music publisher receives or what any specific music publisher's arrangement is.

What the record contains is a stipulation that some of Petitioner's activities were performed in a manner similar to other music publishers typical of the music industry and that the Uniform Popular Songwriters form of contract was used by most publishers. Most significantly, however, pursuant to paragraph 1 of that form of contract, the songwriter "*sells, assigns, transfers and delivers to the Publisher . . . the right to secure copyright . . . and to have and to hold the said copyright and all rights of whatsoever nature thereunder existing . . . .*" In the instant case, the record established directly the opposite: that Petitioner received no assignment, transfer or relevant license of copyright from Irving Berlin, for bona fide reasons which are stipulated, namely, it was Mr. Berlin's determination in 1946, after a bankruptcy in 1929 and a legal dispute in 1943, "that he was never again going to relinquish his ownership of the copyrights." In short, the evidence is overwhelming that the so-called "classic" arrangement relied upon by the court would be demonstrably and significantly different from Petitioner's arrangement and not "in fact" the same, as held below.

It is clear from the court's opinion that it employed a simple syllogism to "prove" its point. The reasoning is that there exists a "classic royalty scheme;" that pursuant to that scheme all outside music publishers receive copyright royalty income; that Petitioner operates in a manner similar to outside music publishers; and that, accordingly, Petitioner also receives copyright royalty income.

But the record contains no factual basis as to what all outside music publishers do, nor any basis for the assumption that all outside music publishers receive copyright royalty income. Whether they do or do not will depend upon their particular arrangements. Most of those using the standard form of songwriters contract will receive assignments of copyrights, and as the owners of the copy-

rights will receive the royalties from their use. But in those cases where the songwriter retains the copyrights himself and uses the publisher to license the songs on his behalf, the songwriter and not the publisher receives the royalty income. The latter is precisely the situation in the case at bar. It is submitted that there is clear factual error in the court's opinion below and that summary judgment was unwarranted on the basis of an assumed state of facts which Petitioner disputes.

3. *Petitioner's arrangement was "operationally identical" to the classic royalty system, "labeled as an agency" and "labeling" the income as "compensation" could not convert it from something else.*

It is claimed by the court that since Petitioner's arrangement was "operationally identical" to the classic royalty arrangement, it necessarily follows that the income received by Petitioner was copyright royalties even though the arrangement between Petitioner and Mr. Berlin was an agency.

The Government did not dispute the agency arrangement nor did the Government contest or question the bona fides of the agency. In its Reply Brief, the Government unequivocally stated:

> Our position is not that taxpayer's agency is a sham ....

Indeed there could be no basis for such a claim. It was stipulated that Mr. Berlin had many valid and legitimate reasons for designating Petitioner as his agent and not assigning his copyrights to Petitioner as would have been the case had the standard songwriters form of contract been adhered to throughout. But, as the record indicates, the standard form of contract was not followed throughout, and, thus, there is no basis for the statement by the Court below that:

> It is precisely the same arrangement, in fact if not in words, which would have existed had a standard

> publishing agreement to an outside firm been negotiated.

Appendix, p. 12a.

That conclusion of fact is critical to the court's opinion and is unwarranted on the basis of the record. The record to the contrary indicates that the standard contract provides for a transfer of the copyrights to the publisher; there was no transfer here. Further, the record shows that Petitioner is an agent; outsiders, to the extent the record shows anything on the issue, are not.

What the court below did was to pay mere lip service to Petitioner's agency arrangement, but in truth and reality, for purposes of its decision, the court disregarded the agency and pierced it—placing "substance over form", without candidly admitting it was doing so. The court throughout its opinion refers to Petitioner's "agency" in hyperbolic and derisive terms in using quotation marks. It refers to Petitioner as "exclusive agent", as having a 1960 "agency agreement", as having received what Mr. Berlin "could, in his unfettered discretion, chose to call . . . agency fees", as a taxpayer whose "sole shareholder simply relabels the amounts received as compensation for the work of an agent", as a party "to an arrangement, operationally identical to the classic royalty system, relabeled as an agency" and as one who by virtue of "relabeling" sought to change copyright royalties into "compensation for agent's services".

The questions are, therefore, whether a true agency was created and whether it was justifiable from an economic and legal standpoint. As to those questions, the Government made no claim of "sham", and while the court was forced to conclude that an agency existed, the court in reality ignored it. But as was stated in *Polak's Frutal Works, Inc.*, 21 T.C. 953, 974 (1954):

> . . . [I]f a taxpayer actually carries on business in the form chosen, the tax collector may not deprive him of the incidental tax benefits flowing therefrom, unless it first be found to be but a fiction or a sham.

See also Gregory v. *Helvering,* 293 U.S. 465 (1935); *Emanuel O. Diamond,* 19 T.C. 727 (1953). There was no such finding of fiction or sham in the instant case—indeed, the finding would be the reverse. Yet, the court below, in fact, disregarded the agency, found that Petitioner's arrangement was operationally identical to all outside music publishers and that those alleged facts mandated a conclusion that Petitioner received copyright royalties. As indicated, the conclusion fails to allow for the reasons why Mr. Berlin retained his copyrights and gave no assignment thereof, received royalties himself and paid Petitioner for its services, albeit in a percentage equal to the normal and customary percentage paid to outside music publishers.[1]

The fact that Mr. Berlin could, "in his unfettered discretion" designate Petitioner as an agent and that Petitioner received agency fees which were equivalent to the royalties which were normal and customary in the industry is neither relevant nor determinative where it is conceded and stipulated that there was ample business justification for Mr. Berlin's not assigning to Petitioner the copyrights to his songs. The test is not what "could" have been done, but rather what was *in fact* done and whether what was done had substantial economic purpose and reality. In *Nassau Lens Co.* v. *Commissioner,* 308 F.2d 39 (2d Cir. 1962), the Government argued that since a stockholder could have allocated his entire investment to equity instead of debt without adverse business conse-

[1] The anomaly of the Government's position and the decision of the court below is that there has been no avoidance of personal income taxes by Mr. Berlin in this case. One-half of the license fees which Petitioner collected as agent were remitted to Mr. Berlin, upon which he paid personal income taxes at a very high tax rate, and the balance were retained as compensation by Petitioner for services rendered. Thus, the tax consequences of the agency do not deprive the Government of the taxes which would have been paid if Mr. Berlin had entered into a contractual arrangement with an outside music publisher which was in a position to avail itself of the remedial provisions of Section 543(a)(4) of the Code. The decision below, however, penalizes Petitioner and all other composers who wish to use their own publishing companies.

quences, a different allocation of the investment in the wholly-owned corporation producing less tax revenue should not be allowed. In rejecting that contention, the Court said:

> It is all very well to say that it makes little "economic" difference whether the investment here was divided between debt and equity or was entirely allocated to equity. But by the same reasoning it may make little "economic" difference to Pildes whether he has an unincorporated business or a corporation in which he is the sole stockholder. And if one wanted to carry the argument far enough, presumably the Commissioner would be free to make *ad hoc* attacks on a whole variety of transactions involving closely held corporations. But this Code does not so empower the Commissioner, for it recognizes and treats corporations as separate entities and affords significance to the type of investment chosen in them so long as that investment has substantial economic reality in terms of the objective factors which normally surround the type chosen.

308 F.2d at 46.

The question whether the agency had economic reality or was a sham is a question of fact. As this Court said in *United States* v. *Cumberland Public Service Co.*, 338 U.S. 451, 454 (1950):

> In this Court the Government contended that whether a liquidation distribution was genuine or merely a sham was traditionally a question of fact. We agreed with this contention, and reinstated the Tax Court's findings and judgments.

The Court went on to say:

> Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may

> dispose of corporate property, we accept its mandate. *It is for the trial court, upon consideration of an entire transaction, to deem the factual category in which a particular transaction belongs.*

Id. at 456 (Emphasis added).

Similarly, in *Chisholm* v. *Commissioner,* 79 F.2d 14, 15 (2d Cir.), *cert. denied,* 296 U.S. 641 (1935), it was made clear that if the form of business arrangement chosen by the taxpayer has economic substance, it is to be given credence, if it is a sham it may be disregarded. The Court stated:

> The question always is whether the transaction under scrutiny is in fact what it appears to be in form; a marriage may be a joke; a contract may be intended only to deceive others; an agreement may have a collateral defeasance. In such cases the transaction as a whole is different from its appearance. True, it is always the intent that controls; and we need not for this occasion press the difference between intent and purpose. We may assume that purpose may be the touchstone, but the purpose which counts is one which defeats or contradicts the apparent transaction, not the purpose to escape taxation which the apparent, but not the whole, transaction would realize.

See also Ambassador Apartments Inc. v. *Commissioner,* 406 F.2d 288 (2d Cir. 1969); *Commissioner* v. *Spermacet Whaling & Shipping Co., S/A.,* 281 F.2d 646 (6th Cir. 1960); *Chamberlain* v. *Commissioner,* 207 F.2d 462 (6th Cir. 1953), *cert. denied,* 347 U.S. 918 (1954); *Metthesin* v. *Commissioner,* 194 F.2d 659 (2d Cir. 1952).

Similarly, as Judge Hand speaking for the Second Circuit said in *Gilbert* v. *Commissioner,* 262 F.2d 512, 514 (2d Cir. 1959):

> The term "substantial economic reality" is merely a way of expressing the fact that the determination

whether the funds advanced are to be regarded as a "capital contribution" or "loan" must be made in light of all the facts of the particular case.

Here, the Court of Claims placed substance over form and made factual determinations and inferences adverse to Petitioner on a motion for summary judgment. Accordingly, this Court's supervisory powers are required to remedy the departure by the Court of Claims from the accepted and established practice with respect to the proper utilization of summary judgment procedure.

II.

The Decision Below Conflicts With Well-Established Principles of the Tax Law, and, If Permitted to Stand, Will Hinder the Just Administration of the Tax Law.

Ever since the passage of the Revenue Act of 1921, Pub. L. No. 98, 42 Stat. 227, 67th Cong., 1st Sess., when Congress first differentiated between the amount of tax to be paid upon capital gains and the amount of tax to be paid on ordinary income, the courts have been required to determine the proper classification of a taxpayer's income for tax purposes. In making those determinations, the principle has become well established that the character of a taxpayer's income is to be determined by reference to the reasons for its receipt by a taxpayer and not by the circumstances giving rise to the production of any income in which the taxpayer is entitled to share. *See, e.g., Merton E. Farr,* 11 T.C. 552 (1948), *aff'd sub. nom., Sloane* v. *Commissioner,* 188 F.2d 254 (6th Cir. 1951); *Strauss* v. *Commissioner,* 168 F.2d 441 (2d Cir. 1948); *Herman Shumlin,* 16 T.C. 407 (1951), *acq.,* 1951-2 Cum. Bull. 4; *Hopag S.A.,* 14 T.C. 38 (1950), acq., 1953-1 Cum. Bull. 4.

The court below rejected this fundamental principle and held, without citation of any authority, that since the original source of Petitioner's income was "copyright royalties"

within the meaning of Section 543(a)(4) of the Code, Petitioner's income ultimately derived from that source also constituted "copyright royalties", notwithstanding that the Petitioner's right to such income was not founded upon the same legal right which ultimately produced such income. The Court of Claims stated:

> The crucial point is that, although designated as compensation for "services", the payment is solely a function, [of] a percentage of the royalties received.

Appendix, p. 12a.

Yet, the crucial inquiry has never been from what source the income arose or how it is to be measured, but, rather has always been for what reason and upon what legal basis is the taxpayer entitled to receive that income. *See Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260 (1958); *Commissioner* v. *Smith*, 324 U.S. 177 (1945); *Hort* v. *Commissioner*, 313 U.S. 28 (1941); *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716 (1929). In this case the copyrights, the use of which produced the royalties, were not owned or held by Petitioner but by Mr. Berlin. The fact that the Petitioner's compensation for rendering promotional and exploitation services performed on behalf of Mr. Berlin was measured as a percentage of the gross receipts derived by Mr. Berlin from his musical compositions promoted by Petitioner is irrelevant to the inquiry as to the true character of Petitioner's income, since never before has the method of computing income been considered to be dispositive of the inquiry as to its proper character. *See, e.g., Martin Charles Ansorge*, 1 T.C. 1160 (1943), *aff'd*, 147 F.2d 459 (2d Cir. 1945); *Schermerhorn Oil Corp.*, 46 B.T.A. 151 (1942).

To conclude, as did the court below, that income which is earned and measured as a percentage of receipts assumes the character of those receipts represents an abrupt and unsupported departure from well-settled law. The error of the court below can be seen from the fact that it stated that the character of Petitioner's income might have been different if it had been measured in a different manner. The Court of Claims stated:

> We need not comment on what result would be reached had plaintiff been compensated under a different formula. It is enough to say that when compensation is "operationally" identical to that of the classic royalty scheme, such payments cannot be converted to something other than copyright royalties for the purpose of that definition.

Appendix, p. 19a. However, the formula used in measuring the compensation has never before been determinative of its character.

Thus, in *Strauss* v. *Commissioner,* 168 F.2d 441, 442-43, (2d Cir.), *cert. denied,* 335 U.S. 858 (1948), it was stated:

> These payments were the result of personal services performed in the past by the taxpayer. The taxpayer did not receive for those services any part of the Kodachrome process itself or any right to control the disposition of that process. Rather, he obtained the enforceable promise of the owners of the process that he would be paid for his services a definite portion of the royalties they had the right to receive from the Eastman Kodak Company. That is to say, his "interest in the process" was never greater than a contract right to be paid certain ascertainable sums of money. From first to last his pay for his services was to be only in money determinable in amount by reference to a royalty agreement covering the process.

Since, as the Court of Appeals for the Eighth Circuit observed in *Estate of Smith* v. *Commissioner,* 313 F.2d 724, 732 (8th Cir. 1963): "[p]ayment for services in the form of a percentage of profits is not an unusual thing in modern business", the decision of the court below threatens the proper determination of tax in innumerable instances. Is the investment advisor who receives a fee measured as a percentage of the income realized from the management of a portfolio of investments which includes municipal bonds

entitled to exclude from his gross income that portion of his fee which is attributable to tax exempt interest? Prior to the decision of the court below the answer to this question was well settled; absent review by this Court, the answer can no longer be free from doubt.

The decision of the court below in the instant case represents an extreme and unwarranted departure from established law. If this decision is allowed to become final, unreviewed by this Court, it will create confusion and uncertainty as to the proper application of a principle which is paramount in the application of the tax law, and thereby will hinder the just and efficient administration of the tax law.

III.

The Decision Below Conflicts With Numerous Decisions of the Tax Court and Courts of Appeals.

The court below concluded that Section 543(a)(4) of the Code, which defines "copyright royalties", does not require a finding of a "proprietary interest" in any copyrighted work. This conclusion conflicts with a long line of decisions in the Tax Court and Court of Appeals, as well as the legislative history and purpose of the personal holding company provisions.

The term "royalties" as a class of personal holding company income has historically and consistently been defined as compensation paid to the owner for the use of or right to use his property. Thus, in *Kiesau Petroleum Corp.*, 42 B.T.A. 69 (1940), *acq.*, 1940-2 Cum. Bull. 4, where the Board of Tax Appeals determined that an interest in profits did not constitute personal holding company income, the Board defined the term "royalty" as follows:

> In construing the words contained in a statute our first resort should be to the natural, ordinary, and familiar meaning of the words used, unless Congress

has definitely indicated an intention that the words should be construed otherwise. We, therefore, turn to the definitions of the word "royalty" as found in the following dictionaries:

Webster's New International Dictionary defines the word "royalty" as (a) A share of the product or profit (as of a mine, forest, etc.) reserved by the owner for permitting another to use the property. (b) A duty or compensation paid to the owner of a patent or a copyright for the use of it or the right to act under it, usually at a certain rate for each article manufactured, used, sold, or the like; also, a percentage, as an output, paid to the owner of an article, especially a machine, by one who hires the use of it.

In Black's Law Dictionary, 3d ed., the word "royalty" is defined as "A payment reserved by the grantor of a patent, lease of a mine, or similar right, and payable proportionately to the use made of the right by the grantee."

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It is apparent from these definitions that the word "royalty" refers to an interest reserved by the owner in return for permission to use the property owned . . . .

42 B.T.A. at 75-6. *See also, Campbell* v. *Great National Life Ins. Co.*, 219 F.2d 693 (5th Cir. 1955); *Hopag S.A.*, 14 T.C. 38 (1950), *acq.*, 1953-1 Cum. Bull. 4; U.S. *Universal Joints Co.*, 46 B.T.A. 111 (1942), *acq.*, 1942-1 Cum. Bull. 17. *Compare Affiliated Enterprises, Inc.* v. *Commissioner*, 140 F.2d 647 (10th Cir. 1944) *with Commissioner* v. *Affiliated Enterprises, Inc.*, 123 F.2d 665 (10th Cir. 1940), *cert. denied*, 315 U.S. 812 (1942).

The decision of the court below was based upon the erroneous assumption that "the drafters of the personal holding company legislation purposefully drew the definition of copyright royalties to encompass precisely the case pres-

ently before us." Appendix, p. 10a. The court below mistakenly concluded that the focus of the definition was not upon any proprietary interest in the copyright but rather upon the words "compensation, however designated, . . ." where the payment of such compensation was "solely a function, a percentage of the royalties received." Appendix, p. 12a.[2]

But, Section 543(a)(4) of the Code neither enlarged the class of income defined as personal holding company income, nor did it change the well defined meaning of copyright royalties. The purpose of the adoption of Section 543(a)(4) of the Code was to provide relief from the threat of personal holding company tax liability for certain music publishers arising out of a change in the nature of the music publishing business, *i.e.,* the decline in the sale of sheet music (nonpersonal holding company income) and a corresponding increase in the receipt of copyright royalties from the greatly expanded use of records and grand and small performing rights. The fact that Petitioner does not fall within the ambit of the relief provisions of Section 543(a)(4) of the Code does not make Petitioner, *ipso facto,* a personal holding company, as the court below, argued.

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[2] What the court below did was to place all of its emphasis on the words "compensation, however, designated," ignoring the concept of paying the owner "for the use of, or the right to use his" copyrighted works, which is, of course, vital to the definition of "copyright royalties." Furthermore, the language chosen by Congress in Section 543(a)(4) of the Code to define "copyright royalties" clearly did not represent any departure from the historic language used in the personal holding company provisions. For example, in the Revenue Act of 1937 Congress defined "rents" as "compensation, however, designated for the use of or the right to use property." 50 Stat. 814. No one would claim however, that a rental agent receives "rent" even though his compensation is measured by a percentage of the rents he collects for his principal. *See also* H. Rep. No. 1546, 75th Cong., 1st Sess. 1939-1 Cum. Bull. (Part 2) 703. In addition, the words "compensation, however, designated, for the use of, or right to use" are not new to Section 543 of the Code. *See* Sections 543(a)(6) and 543(b)(3) of the Code.

In its opinion, the court below completely misinterpreted the intent of Congress in amending Section 543(a) of the Code. The court below stated:

> Simply stated, Congress provided that shareholder—created works could not be exploited without characterizing the royalties thereon as personal holding company income.

Appendix, p. 18a. The Treasury Department, however, stated its position as follows:

> We have been informed that the primary purpose of this bill is to provide relief from the personal holding company tax for certain operating companies in the music publishing business. In our opinion H.R. 7588 will accomplish this *limited* objective without permitting certain tax benefits which do not seem to us desirable . . . .

Report of the Senate Finance Committee to Accompany H.R. 7588, S. Rep. No. 1041, 86th Cong., 2d Sess., at 4. There is not the slightest evidence that Congress intended to overrule many decided cases which had been acquiesced in by the Internal Revenue Service to redefine the "classic definition" of royalties.

For example, royalties on common law copyrights are not included in the definition of "copyright royalties" in Section 543(a)(4) of the Code. Thus, a composer could engage an incorporated agent of which he was the sole shareholder to exploit his common law copyrights and collect royalties on his behalf for the use of, or the right to use the grand performing rights, and, as interpreted by the court below, such royalties would be without Section 543 (a)(4) of the Code. It is evident that Congress did not intend such an absurd result.

Section 543(a)(4) of the Code, insofar as Petitioner's status was concerned, changed nothing. The threshold ques-

tion both before and after the amendment of Section 543(a) of the Code has been whether the income received by Petitioner constituted copyright royalties as that term has always been defined and used and not whether Petitioner could meet the conditions as set forth in Sections 543(a)(4)(A), (B) and (C) of the Code, providing relief from the personal holding company tax for certain music publishers. It is no answer to say that Congress withheld the exemption or relief given by the statute from shareholder related companies. It is necessary in any case first to determine whether the company, related or unrelated received copyright royalties. In the instant case, as previously shown, Petitioner as an agent did not receive copyright royalties, unless the agency is disregarded, which raises a sharp factual dispute.

The court below disregarded the well established precedents by merely stating that they predated the relief amendment to Section 543(a) of the Code without citing any authority for the unique proposition that a person can receive royalty income without having a property right in a copyright. It is, indeed, impossible to believe that the legislative Drafting Department of the Treasury, the Joint Committee on Internal Revenue Taxation and its experts, The House Ways and Means Committee and The Senate Financial Committee, as well as both houses of Congress, would wipe out long established case law acquiesced in by the Commissioner of Internal Revenue Service, without a single sentence in the Committee Reports evidencing such intention. Whenever Congress has intended to enlarge the type of income classified as personal holding company income it has indicated its intentions in clear unmistakable language.[3] The Committee Reports accompanying the

[3] For example, when Congress intended to broaden the definition of "copyright royalties" in 1964 it clearly said so:

> The definition of copyright royalties in paragraph (4) of section 543(a) is *broadened* to include payments other than produced film rents as defined in sec. 543(a)(5)(B) received for the use of, or right to use, films.

Report to Accompany H.R. 8363, H. Rep. No. 749, 88th Cong., 1st Sess., at A97, 1964-1 (Part 2) Cum. Bull. 345 (emphasis added).

amendment of Section 543(a) of the Code are devoid of any indication that Congress sought to expand or enlarge the classes of income characterized as personal holding company income, and none should be presumed.

The conclusion of the court below, that Congress intended to eliminate the requirement that the recipient of royalties have a proprietary interest in the copyright itself, is also contradicted by the Treasury Regulations. Thus, Treas. Reg. Section 1.543-1(b)(12)(i), T.D. 6308, 1958-2 Cum. Bull. 279, as amended by T.D. 6739, 1964-2 Cum. Bull. 156, provides:

> The income from copyright royalties constitutes, generally, personal holding company income. However, for taxable years beginning after December 31, 1959, *those copyright royalties which come within the definition of 'copyright royalties' in section 543(a)(9) new section 543(a) and subdivision (iv) of this paragraph shall be excluded from personal holding company income* only if the conditions set forth in subdivision (ii) of this subparagraph are satisfied.

(Emphasis added) As is obvious from the Treasury Regulations, the purpose of the definition of "copyright royalties" is limited to identifying those copyright royalties which, if they meet certain criteria, are eligible for exclusion from classification as personal holding company income; and the definition was never intended by Congress to be part of a broad and expansive scheme to tax in areas never taxed before.

Furthermore, under well established principles of statutory interpretation, Congress is presumed to be aware of prior judicial constructions, and when utilizing words having a well defined meaning, such meaning should continue to be applied unless there is clear evidence to the contrary.

Thus, as this Court said in *Deputy* v. *du Pont,* 308 U.S. 488, 498 (1939):

> We are dealing with the context of a revenue act and words which have today a well-known meaning .... In absence of clear evidence to the contrary, we assume that Congress has used these words in that sense. In sum, we cannot sacrifice the "plain, obvious and rational meaning" of the statute even for the "exigency of a hard case."

See also Real Estate-Land Title and Trust Co. v. *U.S.,* 309 U.S. 13 (1940); *United States* v. *Merriam,* 263 U.S. 179 (1923); *Kiesau Petroleum Corp., supra.*

The decision of the court below represents an abrupt and unsupported departure from existing law and usurps the legislature function by imposing a tax on a transaction which Congress itself did not seek to tax. Petitioner at all times was acting as an agent for Mr. Berlin and as such had no property interest in his copyrights. The decision below is the first decision interpreting Section 543(a)(4) of the Code. It conflicts with well established prior law and substantially and adversely affects every author, composer and artist who, for nontax purposes, attempts to operate his own music publishing business in competition with the outside giant music publishers. Therefore, it is respectfully requested that this Court grant Petitioner's petition for a writ of certiorari to review the judgment below.

CONCLUSION

The issues in this case involve important questions of law and procedure and the decision below conflicts with heretofore firmly established legal principles. The case is novel and involves the construction of an important tax statute. The sums involved are substantial and will have continuing effect since copyright life with renewals is 56 years. The

authority of this Court is necessary to resolve these important matters. In view of all of the foregoing, a writ of certiorari should issue to review the judgment and opinion of the Court of Claims.

Respectfully submitted,

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May 17, 1974

APPENDIX

APPENDIX A

Opinion of the Court of Claims

IN THE UNITED STATES COURT OF CLAIMS

No. 508–69

(Decided November 14, 1973)

IRVING BERLIN MUSIC CORPORATION v. THE UNITED STATES

William F. Sondericker, attorney of record, for plaintiff. *Richard B. Rodman* and *Richard D. Belford,* of counsel.

Richard B. Stone, with whom was *Assistant Attorney General Scott P. Crampton,* for defendant. *Gilbert E. Andrews* and *Theodore D. Peyser,* of counsel.

Before COWEN, *Chief Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges.*

ON DEFENDANT'S MOTION AND PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT

KASHIWA, Judge, delivered the opinion of the court:

Plaintiff filed this suit for the refund of federal personal holding company income taxes and assessed interest for the fiscal years ended January 31, 1965, and January 31, 1966, in the respective amounts of $137,524 and $160,851, plus interest.

The case comes before us on defendant's motion for summary judgment and plaintiff's cross-motion for summary judgment. The facts are stipulated and there are no material issues of fact. We hold for the defendant for the reasons hereinafter stated.

The essential facts are as follows. Irving Berlin has composed about 1,000 musical compositions, of which about 650

continued to be published and offered for sale to the general public and to professional users of music during the tax years in question. In 1946 he incorporated Irving Berlin Music Corporation (hereinafter Berlin Music), a New York corporation. Irving Berlin has been the sole owner of all of the authorized and issued capital stock of Berlin Music since its formation. In 1946 Irving Berlin entered into an agreement with Berlin Music establishing their working relationship much along the lines prescribed by the Songwriters Protective Association standard form contract used by most music publishers in the industry.[1]

On January 31, 1960, Irving Berlin and Berlin Music entered into a new agreement superseding the earlier 1946 agreement. Under the 1960 agreement, Berlin Music continued as exclusive licensee to publish or issue licenses to publish the music compositions of Irving Berlin; however, Irving Berlin engaged Berlin Music to act as his "exclusive agent"[2] to: (1) issue licenses to manufacture parts of instruments serving to mechanically reproduce his composi-

[1] By this agreement, Irving Berlin granted to his corporation, which he designated as "Publisher," among other things, the exclusive license to: (1) publish and issue licenses to publish his musical compositions worldwide; (2) issue licenses authorizing the manufacture of parts of instruments serving to mechanically reproduce his compositions worldwide; (3) issue licenses to reproduce his compositions worldwide for broadcasting purposes; (4) issue licenses with regard to all performing rights protected by all domestic and foreign copyrights to his musical compositions; and (5) generally to exploit and market such musical compositions and rights therein. The corporation was entitled to retain the proceeds from the sale of sheet music less a set royalty on each sale. As additional compensation for its services, the corporation was entitled to deduct and retain 50 per cent of the gross fees it derived from licenses and to retain fully the publisher's share of the distributions from the American Society of Composers, Authors and Publishers (ASCAP), or other performing rights societies.

[2] Originally, it appeared that the change from the 1946 "license agreement" to the 1960 "agency agreement" was the basis upon which the taxpayer was building his argument. However, the taxpayer argued the case on the theory that, even under the 1946 con-

tions; (2) issue licenses to reproduce his compositions for broadcasting purposes; and (3) issue licenses with regard to all performing rights to his music. The publisher's share of the compensation remained substantially the same as under the 1946 agreement.

Ever since its establishment, Berlin Music has been actively engaged in the music-publishing business. During the tax years in question, the company's activities [3] were performed solely with respect to compositions created in whole or in part by Irving Berlin, its sole shareholder. The Government does not make the claim that Berlin Music was a mere sham corporation. Indeed, in light of the substantial

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tract, an agency was intended; and the word "license" was used but did not accurately describe the arrangement. In any event, the taxpayer does not allege that the change significantly altered the nature of the music-publisher services it performed on behalf of Irving Berlin, including licensing, as well as the method by which all of such services were performed. Like other established music publishers, taxpayer continued under the 1960 agreement, as under the earlier 1946 agreement, to receive 50 per cent of the gross royalties derived from performing rights licenses it issued to music users for the use of Irving Berlin's songs.

[3] These activities can be categorized and described as follows:

(a) *Development of Songs.* Plaintiff assisted Irving Berlin in preparing musical compositions for initial commercial and professional use. Plaintiff's activities in this regard involved such technical aspects as the transcription of compositions in musical form.

(b) *Preparation of Musical Arrangements.* Plaintiff's employees prepared piano forte arrangements of each of Irving Berlin's compositions for sale to the general public in sheet music form. In addition, plaintiff caused to be prepared arrangements for every conceivable user or purchaser of popular music. Plaintiff also prepared or caused to be prepared professional arrangements to be used by particular orchestras in connection with the promotion and exploitation of a particular musical composition.

(c) *Exploitation and Sales Promotion Services.* Plaintiff supervised and conducted the sales of sheet music and the distribution of professional arrangements of Irving Berlin's compositions. Sales of sheet music and arrangements were handled by plaintiff's sales staff which called upon all major music stores and music jobbers throughout the United States.

business activity of the plaintiff, as well as the admitted bona fide business purpose in creating the company, no such claim is feasible.

In today's music industry, the composition of a song is only the first step in a highly sophisticated system of song creation, promotion, and distribution. By way of illustration, one powerful force in the music industry is the American Society of Composers, Authors and Publishers (hereinafter

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In some instances, as part of the promotion and exploitation of Irving Berlin's songs, plaintiff also prepared special arrangements of songs to suit the particular style of many well-known singing personalities. This was done either by arrangers employed by the plaintiff or done by outside independent arrangers hired and paid for by the plaintiff for each particular transaction.

To exploit and promote Irving Berlin's compositions, the plaintiff employed "professional men" known to the public as "song pluggers," whose responsibility was to make the rounds of orchestra leaders, band leaders, singers, instrumentalists, recording companies and producers of radio and television shows in order to insure frequent performances of the compositions. These men kept a constant watch on all users of songs whose public performance of a song would bring it to the public attention and create a demand for sheet music or records. In addition, demonstration records were made at plaintiff's expense of any song deemed promising which was then given to recording companies, disc jockeys, and the like.

(d) *Licensing.* The major revenues obtained from the exploitation of musical compositions were, during the taxable years in question, derived from the "grand performing rights" which included legitimate stage productions, electrical transcriptions, phonograph records, motion picture synchronization, stock and amateur rights, and dramatic uses on radio and television. Each grant or license of a grand performing right had to be separately negotiated and issued. During the life span of a particular song, such licenses number many hundreds requiring specialized business expertise to achieve the highest possible royalties to the author/composer without pricing the musical composition out of the market. Plaintiff, as "agent" and/or its subagents negotiated, prepared, and granted such licenses. Any unusual or significant request required the personal approval and consent of Irving Berlin before a license would be issued. No performing rights licenses were ever issued over Irving Berlin's objection.

(e) *Bookkeeping and Accounting.*

(f) *Stock Room and Shipping.*

ASCAP). ASCAP's constitution provides for two classes of participating membership: first, author and composer (or writer) membership, and, second, publisher membership. Irving Berlin was an original founder-member of ASCAP and remains a writer member to date. As a condition to writer membership, each writer member agrees that during the term of his written agreement with ASCAP, the nonexclusive, nondramatic rights of public performance of the writer's musical compositions then existing or created during the term of his agreement are immediately vested in ASCAP.

Berlin Music has been a publisher member of ASCAP from its inception and continues so to be. Each publisher member, as a condition to membership, agrees that during the term of its written agreement, the nonexclusive, nondramatic rights of public performance of compositions published by it during the term of its agreement are vested in ASCAP.

ASCAP is a performing rights society. It has nothing to sell—no sheet music, no phonograph records, no "Broadway musicals," no musicians or vocalists. ASCAP simply licenses radio stations and networks, television stations and networks, wired music services, orchestras, electrical transcribers, and others who perform musical compositions for profit, to perform nondramatic performances of all compositions in its catalogues in return for payment of royalties by such music users. Nondramatic performing rights are commonly referred to in the music industry as "small performing rights." After payment of operating expenses and such reserves as are established by the ASCAP board of directors, the remaining royalties are divided into two pools, a writers' pool and a publishers' pool, each pool receiving 50 percent of the royalties which are thereafter distributed to the writer members and the publisher members.

In discussions with ASCAP as to its requirements for recognition of Berlin Music as a publisher member, ASCAP

insisted that Berlin Music obtain from Irving Berlin, the copyright owner, an exclusive printing and publishing license, but it did not object to Irving Berlin's desire personally to retain title to his song copyrights and engage his corporation as exclusive agent therefor. Accordingly, the publishers' share of the ASCAP royalties from small performing rights licenses issued for the use of Irving Berlin's musical compositions were distributed quarterly by ASCAP to Berlin Music as a publisher member.

The major revenues obtained from the exploitation and promotion of musical compositions by music publishers are derived from royalties paid by music users for grand performing rights licenses. It is with respect to grand performing rights that the controversy in this case arises. Unlike the situation with respect to ASCAP, no actual license was granted to Berlin Music. Unlike the small performing rights licenses handled by ASCAP, grand performing rights encompass dramatic performances of music, including legitimate stage productions, electrical transcriptions, phonograph records, motion picture sound synchronization, stock and amateur theater rights, and dramatic uses on radio and television. Finally, unlike small performing rights to Irving Berlin's music, grand performing rights licenses are not within the purview of ASCAP's authority but are separately negotiated and issued by Berlin Music to music users. Berlin Music collects royalties from music users under licenses issued solely for the use of or the right to use Irving Berlin's musical compositions. In the case of recording companies, Berlin Music typically employs the Harry Fox Agency, whose responsibility it is, as agent and trustee, to execute such licenses and collect and remit the royalties therefrom to Berlin Music. During the life span of a particular song, these licenses number many hundreds, requiring specialized business expertise to achieve the highest possible royalties without pricing the musical composition out of the market.

It has been stipulated that all of the services performed by Berlin Music were performed in a manner similar to other established music publishers typical of the music industry. Under *both* the 1946 and 1960 agreements between Irving Berlin and his corporation, Berlin Music was empowered to deduct and retain as compensation for its music publisher services 50 per cent of the gross royalties paid by music users to Berlin Music under the performing rights licenses it issued. This arrangement represented the normal and customary percentage in the music industry as evidenced by the Songwriters Protective Association standard form contract. In addition, as with the standard form contract, *supra*, Berlin Music was also entitled to the royalties distributed to it by ASCAP as the result of its publisher membership and, as concerns the sale of printed sheet music, Berlin Music typically agreed to pay to Irving Berlin a fixed royalty as to each type of sheet music arrangement sold.

During the fiscal years ended January 31, 1965, and January 31, 1966, Berlin Music deducted and retained $233,877 and $230,565, respectively, as the 50 per cent portions of the gross royalties paid by music users under the performing rights licenses it issued for the use of or the right to use Irving Berlin's songs. In a statutory notice of deficiency dated June 9, 1967, the Government determined that these amounts constituted copyright royalties under section 543 (a)(4) of the Internal Revenue Code of 1954,[4] and, therefore, that Berlin Music was a personal holding company under section 542(a) of the Code.

The case was ably briefed and argued by the respective counsel for plaintiff and defendant, and the parties have succeeded in narrowing the issue before us to one of statutory construction. We are called upon to determine whether the shares of copyright royalties received and retained by taxpayer Berlin Music under performing rights licenses is-

[4] All statutory references are to the Internal Revenue Code of 1954, as amended, unless otherwise stated.

sued to music users for the right to use the musical compositions of taxpayer's sole stockholder, Irving Berlin, constitute copyright royalties to it within the meaning of section 543(a)(4) and hence are subject to the tax on personal holding company income; or whether such amounts are merely compensation for services rendered.

The provisions dealing with personal holding companies (sections 541-547) have been a part of the federal tax law since 1937. Basically, the tax, now at a 70 per cent level, is imposed upon the undistributed income of those companies classified as personal holding companies. The basic factors which enter into this classification have been summarized as follows:

> * * * *To constitute a personal holding company, a corporation must meet both an income test and a stock ownership test, viz., at least 60 percent of its "adjusted ordinary gross income" must be "personal holding company income" (primarily passive investment income, plus personal service income in the case of "incorporated talents," * * *); and more than 50 percent of its stock (by value) must be owned—directly or indirectly, actually or constructively—by five or fewer individuals * * *. [Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders 8-34, 8-35 (3d ed. 1971).]

Section 543, the relevant portions of which are set forth in the margin,[5] defines exactly what income is to be classified

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[5] SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) *General rule.* For purposes of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

(1) *Dividends, etc.* Dividends, interest, royalties (other than mineral, oil, or gas royalties or copyright royalties), and annuities. * * *

* * * * *

(4) *Copyright royalties.* Copyright royalties; except that copyright royalties shall not be included if—

(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created

as "personal holding company income." Section 543(a)(4) is a long, intricate, but not altogether lucid paragraph which includes copyright royalties within the definition of personal

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in whole or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

(B) the personal holding company income for the taxable year computed—

(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and,

(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

(i) deductions for compensation for personal services rendered by the shareholders,

(ii) deductions for royalties paid or accrued, and

(iii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties.

For purposes of this subsection, the term "copyright royalties" means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B)) received for the use of, or right to use, films. For purposes of this paragraph, the term "shareholder" shall include any person who owns stock within the meaning of section 544.

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holding company income; excepts from this broad inclusion certain types of copyright royalties; and seeks to define exactly what is meant by the term "copyright royalties." This definition is at the core of our inquiry:

> *For purposes of this subsection,* the term "copyright royalties" means *compensation, however designated,* for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, *or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work* * * *.[Emphasis supplied.]

Essentially, the taxpayer argues that for the definition of copyright royalties, included as one form of personal holding company income, we need look no further than the law of copyrights. It is asserted that section 543(a)(4) effectively adopts the copyright law definition, the latter of which requires that the party receiving "royalties" must hold a proprietary interest in the copyright. Since Berlin Music never had a proprietary interest in Irving Berlin's copyrights, plaintiff would halt our inquiry at the definitional level. Thus, according to plaintiff, Berlin Music never received "copyright royalties" but only mere compensation for services rendered. We cannot agree.

It is our view that the drafters of the personal holding company legislation purposefully drew the definition of copyright royalties to encompass precisely the case presently before us. The definition begins with words of limitation: "For purposes of this subsection, * * *." Thus, the definition is not to have application for every section of the Code but is to be limited to subsection (a) of section 543. We have noted in previous opinions that drafters of tax legislation have demonstrated keen awareness of the technique of identifying

the scope of definitions. For example, the definition of a life insurance company in section 801(a) is to apply "[f]or purposes of this subtitle," i.e., Code sections 1 through 1564. On the other hand, section 804(a)(1) refers to a rule solely "[f]or purposes of the preceding sentence * * *." See *United American Ins. Co.* v. *United States*, 201 Ct. Cl. 32, 44-46, 475 F.2d 612, 619-620 (1973). Thus we begin our inquiry into the definition of the term "copyright royalties" with the knowledge that the definition is to apply for purposes of identifying personal holding company income; i.e., "[f]or purposes of * * * subsection [(a) of section 543]."

While Congress could have merely adopted the definition of royalties contained in the copyright laws, this procedure was not followed. Rather, copyright royalties, for personal holding company income purposes, was broadly and specially defined as

> * * * *compensation, however designated,* for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code * * *, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work * * *. [Emphasis supplied.]

The focus is thus not upon any proprietary interest in the copyright but rather that "compensation, however designated" be classified as copyright royalties (and, ultimately, as personal holding company income) when it is paid "for use of, or the right to use, copyrights." [6] We find that para-

[6] It is also significant, although not directly applicable to the problem of grand performing rights, that the definition of copyright royalties also "includes payments from any person for performing rights in any such copyrighted work." Thus, the royalty payments from ASCAP, half of which, after adjustments, were paid to Berlin Music, are clearly copyright royalties. It is noteworthy that, if anything, this language is an even clearer indication that the traditional notions (i.e., the proprietary interest requirement) as to what the status of

graph 10 of the 1960 agreement brings the income within the statutory definition when it was provided that

> 10. As full compensation for Publisher's services, Writer agrees that Publisher may deduct and retain 50% of the gross license fees received by Publisher as Writer's agent from licenses granted by Publisher on Writer's behalf, pursuant to the terms and provisions of Paragraph 3 hereof.

The crucial point is that, although designated as compensation for "services," the payment is solely a function, a percentage of the royalties received. Berlin Music was far more than a mere collection agent. It had the exclusive right throughout the term of the copyrights to issue licenses (subject to Irving Berlin's personal approval in the case of an unusual or significant arrangement; see Footnote 3(d), *supra*) and, in general, to exploit those copyrights in return for which it received 50 per cent of the royalties derived from the copyrights. It is precisely the same arrangement, in fact if not in words, which would have existed had a standard publishing agreement to an outside firm been negotiated.

Irving Berlin was the sole shareholder of Berlin Music and could, in his unfettered discretion, choose to call the amounts retained by Berlin Music agency fees. However, whatever the consequences of this decision are in other tax and non-tax areas, with respect to personal holding companies, such a unilateral classification cannot alter what are, otherwise, copyright royalties in the hands of Berlin Music. The detailed and specific definition of copyright royalties for purposes of personal holding company income leaves no room for plaintiff's argument that royalties cannot exist in

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a royalty recipient must be were being abandoned. Rather than concentrating on what proprietary relationships, if any, were required by the nature of the business, the choice of the word "payments" is suggestive that the compensation to be divided equally between writer and publisher was to be tainted as copyright royalties irrespective of technical arrangements.

the hands of a taxpayer not having a proprietary interest in the copyright.

Perhaps the best proof of what Congress meant by "copyright royalties" is the recent (1960) legislation on the subject. Prior to 1960, section 543(a)(1), as then in effect, merely defined personal holding company income to include royalties:

> SEC. 543. PERSONAL HOLDING COMPANY INCOME.
>
> (a) *General Rule.* For purposes of this subtitle, the term "personal holding company income" means the portion of the gross income which consists of:
>
> (1) *Dividends, etc.* Dividends, interest, royalties (other than mineral, oil, or gas royalties), and annuities. * * *
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Section 543 was amended in 1960 to deal more specifically with copyright royalties by P.L. 86-435, 74 Stat. 77. The reasons prompting this legislation are well stated in a Treasury Department Memorandum made a part of the Senate Committee on Finance Report pertaining to the bill ultimately enacted, H.R. 7588. The following excerpts from the Treasury memorandum bear crucially upon our inquiry:

> 3. *Legislative history*
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> The personal holding company provisions, first enacted in 1934, were developed to prevent the avoidance of income tax on individuals by means of the formation of closely held corporations to which were transferred the individuals' investments and services or talents. In addition to the regular corporation income tax, personal holding companies are subject to a special tax of 75 percent of the first $2,000 of undistributed personal holding company income plus 85 percent of such income in excess of $2,000. A corporation may, however, avoid the imposition of the personal holding company tax by

actual or consent distributions of its personal holding company income. The personal holding company provisions have been modified over the years since 1934, but the fundamental purpose has not been altered by succeeding Congresses.

Personal holding company income is, in general, that income which is received from certain types of investment and personal service sources as specified in the code. Although the legislative history of the personal holding company provisions indicates, as a general rule, an intent not to apply such penalty tax to a true operating company, an operating company is not ipso facto excluded from the classification as a personal holding company and there is no indication that a true operating company could, or should, never be classified as a personal holding company.

The Treasury Department opposed an earlier version of the bill (H.R. 5478, introduced in the 1st sess. of the 85th Cong.) in a report to the House Ways and Means Committee, dated July 18, 1957, on the grounds that the terms used in the bill were too general and might permit avoidance of the personal holding company tax by many corporations to which the tax should appropriately apply. A revised bill (H.R. 8960, introduced in the same session) met some of our earlier objections, and was passed by the House of Representatives on August 16, 1957. However, the Department continued to study this matter and became concerned that the bill might still permit certain tax benefits which do not seem desirable. Therefore, we reported to your committee on January 28, 1958, that we were opposed to the enactment of H.R. 8960. H.R. 7588 appears to have met all of our objections to H.R. 8960.

4. *Comments on the bill*

(a) *Policy.* Prior studies have been made regarding the amendment of the personal holding company provi-

sions to provide relief from the personal holding company tax for corporations engaged in the music publishing business. It appears that a reasonably favorable showing has been made that some music publishers are operating companies and should not be subjected to the personal holding company tax merely by reason of the fact that their chief source of income consists of "copyright royalties." (See H. Rept. No. 1047, 85th Cong., 1st sess., on H.R. 8960.) It was pointed out that recent developments have tended to shift the source of income of music publishers from the sale of sheet music (which is not personal holding company income) to royalty income (which is personal holding company income), a shift that is due in part to the fact that radio, motion pictures, and television, and the expansion in the use of phonograph records have increased the royalty income derived from song copyrights, and in part to the fact that the more extensive use of the services provided by performing rights societies has increased the royalty income from live performances of songs by orchestras and others in hotels, night clubs, theaters, and in television. As a result of technological and other changes in the music-publishing industry, publishers today receive much of their income from royalties but, despite that fact, it is contended that most music publishers are not passive investment-type organizations.

Our principal objection to H.R. 8960 was that it would apparently have been possible for a composer of a song to incorporate and, by incurring costs in promoting the song equal to more than 50 percent of his gross income from the song, avoid both the personal holding company tax and the higher personal income tax rates that might be applicable if he did not incorporate. H.R. 7588 meets this objection by excluding royalties received from copyrights or works created by any shareholder from the 50 percent or more of gross income test. [Emphasis sup-

plied.] [S. Rep. No. 1041, 86th Cong., 2d SESS., pp. 5-6 (1960) (1960-1 CUM. BULL. 817, 820-821).]

Further, the Committee's own summary of the bill gives every indication that the amendment with respect to publishing firms was being applied to a broad definition of copyright royalties:

> * * * Copyright royalties are defined as compensation with respect to copyrights protected by the U.S. Government, or protected by the laws of other countries as a result of international treaties, etc., or interests in these copyrights. They are also to include payments with respect to those copyrights received from performing rights societies or organizations. * * * [S. Rep. No. 1041, 86th Cong., 2d SESS., p. 2 (1960) (1960-1 CUM. BULL. 817, 818).]

Section 543(a)(4)(A) translates this Congressional purpose into law. Although the general rule is to be that copyright royalties are classified as one variety of personal holding company income, copyright royalties will not be so included if

> (a) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

Subparagraphs (B) and (C) further carry out the Congressional purpose of insuring that in order to qualify for the exemption, the company is actively engaged in the publishing business. What is significant about subparagraph (A) for our purposes is that for companies exploiting shareholder-created works, no amount of business activity on the part of the company will entitle that company to have its income exempted from the taint of copyright royalty personal holding company income. In the case of companies ex-

ploiting shareholder-created works and receiving copyright royalties, the intensity of business activity is totally irrelevant. Thus, plaintiff's discussion of the bona fides of Irving Berlin's need for a company to exploit his works and of the scope of the business activity of the company is really beside the point. Congress chose not to confer the benefit when shareholder-created works were being exploited. We have before us the ultimate example of Congressional concern, as Berlin Music publishes nothing but the songs of its 100 per cent shareholder.

Plaintiff's position in this case is that it could not, in any event, take advantage of the active publishing business exception contained in section 543(a)(4) (A), (B), and (C) because Irving Berlin, whose songs were being exploited and services by Berlin Music, owned 100 per cent of the stock of the plaintiff. However, plaintiff urges that the problems addressed by this aspect of the statute are beyond the facts of a case in which no "copyright royalties" are received. It is our view that the plaintiff's definition of copyright royalties is so narrowly and technically circumscribed as to lead inexorably to a strained reading of the statute as a whole and to an effective undercutting of the intent displayed by Congress in enacting the 1960 limited amendments.

In enacting section 543(a)(4) (A), (B), and (C), Congress undoubtedly intended to exclude certain qualifying music publishers from the burden of the personal holding company tax. Berlin Music, however, simply does not fall within this exceptional class. Congress evidently determined that the relationship between an author and his own publishing company, regardless of the formal arrangements (dictated by the shareholder) governing that relationship and regardless of the similarities the company might bear to any other active publishing company, gave rise to the potential for use of that company as an "incorporated pocketbook" against which the personal holding company tax is aimed. Plaintiff's interpretation of the statute would eat into the very fiber of this Congressional purpose.

Having withheld the benefits of the active publisher exception from taxpayers in plaintiff's position, we cannot ascribe to Congress an intent to open a loophole to a taxpayer when its sole shareholder simply relabels the amounts received as compensation for the work of an agent. In the context of a broad definition of copyright royalties together with a definite line being drawn between outside versus related companies, we cannot accept an argument that Congress intended to attach any significance to an arrangement, operationally [7] identical to the classic royalty system, relabeled as an agency. It is for this very reason that Congress chose to give its broad definition, for purposes of subsection 543(a), to the term "copyright royalties." [8] Under the plaintiff's definition, on the other hand, any composer-shareholder of a closely held music publisher, engaged in issuing performing rights licenses in his behalf, would be permitted totally to

[7] The taxpayer admitted, during oral argument, that the arrangement in the instant case was "operationally" identical with a classic royalty arrangement. The taxpayer attempted to distinguish the two cases by arguing that different consequences, such as those occurring in bankruptcy, resulted from a choice of system. Plaintiff even conceded that had a nonexclusive license been granted to Berlin Music, this would have been a sufficient interest to require a holding that copyright royalties had been received. While it is true that different consequences, such as on bankruptcy, may result (and while we admit that in different contexts we might be persuaded that these differences could command different tax treatment), Congress' concern, at least with respect to personal holding company income, was specific: not to allow a benefit to companies deriving as income, however, this compensation is designated, a percentage of the copyright royalties collected. Simply stated, Congress provided that shareholder-created works could not be exploited without characterizing the royalties thereon as personal holding company income.

[8] It has long been a basic principle of statutory innterpretation that "* * * the court will not look merely to a particular clause in which general words may be used, but will take in connection with it the whole statute (or statutes on the same subject) and the objects and policy of the law, as indicated by its various provisions, and give to it such a construction as will carry into execution the will of the legislature, as thus ascertained, according to its true intent and meaning." [*Brown* v. *Duchesne*, 60 U.S. (19 How.) 183, 194 (1856).]

frustrate the statute by merely relabeling the 50 per cent share of copyright royalties otherwise charged by unrelated music publishers as "compansation for agent's services." Congress could never have intended such an anomalous result; and, therefore, it cannot be reasonably imputed to the very broadly framed statute defining copyright royalties. See *Select Tire Salvage Co.* v. *United States,* 181 Ct. Cl. 695, 703, 386 F. 2d 1008, 1012 (1967). We need not comment on what result would be reached had plaintiff been compensated under a different formula. It is enough to say that when compensation is "operationally" identical to that of the classic royalty scheme, such payments cannot be converted to something other than copyright royalties for the purpose of that definition.

We hold that section 543(a)(4) simply does not define copyright royalties in a manner which requires a finding of a "proprietary interest" in the underlying copyright. The definition does not spring from a finding of proprietary interest but rather from the situation in which compensation is to be measured in terms of a percentage of the royalties paid for the use or right to use copyrights.[9]

For the foregoing reasons, we hold for the defendant and allow its motion for summary judgment. Plaintiff's cross-motion for summary judgment is denied and the petition is hereby dismissed.

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[9] Cases cited, such as *Kiesau Petroleum Corp.*, 42 BTA 69 (1940), *Campbell* v. *Great Nat'l. Life Ins. Co.*, 219 F. 2d 693 (5th Cir. 1955), and *Hopag, S. A.*, 14 T.C. 38 (1950), by plaintiff for the proposition that a proprietary interest in the copyright is a *sine qua non* to a finding of royalty income, predate the 1960 amendments to the personal holding company provisions and do not deal with the specific statutory definition of copyright royalties at issue here.

Order of the Court of Claims

IN THE UNITED STATES COURT OF CLAIMS

508–69	IRVING BERLIN MUSIC CORPORATION	v. THE UNITED STATES
840–71	JULIUS PETROFSKY, d/b/a PETROF TRADING COMPANY	
184–73	DONALD A. CONLON	
186–73	WILBUR O. MORTON	
187–73	DELBERT D. LODDY	
209–73	DELBERT D. LODDY	
219–73	DELBERT D. LODDY	
229–73	DELBERT D. LODDY	
230–73	DELBERT D. LODDY	
260–73	LOUIS D. COSCO	
261–73	DELBERT D. LODDY	
286–73	ROBERT R. COLLINGWOOD	

Before COWEN, *Chief Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges,* except that the *Chief Judge* and BENNETT, *Judge,* participated only in No. 508–69, SKELTON and NICHOLS, *Judges,* did not participate in No. 840–71 and KASHIWA and KUNZIG, *Judges,* participated only in Nos. 508–69 and 840–71.

ORDER

These cases come before the court on motions for rehearing, new trial, to alter or amend judgment, for oral argument and for further relief under Rules 151 and 152 of the Rules of this court and, on consideration thereof,

Order of the Court of Claims

IT IS ORDERED this 20th day of February, 1974, that said motions be and the same are denied as follows:

508–69 Irving Berlin Music Corporation. Plaintiff's motion to alter or amend judgment.

840–71 Julius Petrofsky, d/b/a Petrof Trading Company. Plaintiff's motion for rehearing.

184–73 Donald A. Conlon

186–73 Wilbur O. Morton. Appellants' (plaintiffs') motion for rehearing or new trial and motion for oral argument.

187–73 Delbert D. Loddy and 7 related cases (209–73; 219–73; 229–73; 230–73; 260–73; 261–73 and 286–73). Appellants' (plaintiffs') motion for rehearing and/or for new trial.

BY THE COURT

WILSON COWEN
Chief Judge

APPENDIX B

Statute Involved

Internal Revenue Code of 1954, as amended, 26 U.S.C., Vol. 6, at 6555-6556 (1970):

SEC. 543. PERSONAL HOLDING COMPANY INCOME.

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company income" means the portion of the adjusted ordinary gross income which consists of:

(4) COPYRIGHT ROYALTIES.—Copyright royalties; except that copyright royalties shall not be included if—

(A) such royalties (exclusive of royalties received for the use of, or right to use, copyrights or interests in copyrights on works created in whole, or in part, by any shareholder) constitute 50 percent or more of the ordinary gross income,

(B) the personal holding company income for the taxable year computed—

(i) without regard to copyright royalties, other than royalties received for the use of, or right to use, copyrights or interests in copyrights in works created in whole, or in part, by any shareholder owning more than 10 percent of the total outstanding capital stock of the corporation,

(ii) without regard to dividends from any corporation in which the taxpayer owns at least 50 percent of all classes of stock entitled to vote and at least 50 percent of the total value of all classes of stock and which corporation meets the requirements of this subparagraph and subparagraphs (A) and (C), and

(iii) by including as personal holding company income the adjusted income from rents and the adjusted income from mineral, oil, and gas royalties,

is not more than 10 percent of the ordinary gross income, and

(C) the sum of the deductions which are properly allocable to such royalties and which are allowable under section 162, other than—

(i) deductions for compensation for personal services rendered by the shareholders,

(ii) deductions for royalties paid or accrued, and

(iii) deductions which are specifically allowable under sections other than section 162,

equals or exceeds 25 percent of the amount by which the ordinary gross income exceeds the sum of the royalties paid or accrued and the amounts allowable as deductions under section 167 (relating to depreciation) with respect to copyright royalties. For purposes of this subsection, the term "copyright royalties" means compensation, however designated, for the use of, or the right to use, copyrights in works protected by copyright issued under title 17 of the United States Code (other than by reason of section 2 or 6 thereof) and to which copyright protection is also extended by the laws of any country other than the United States of America by virtue of any international treaty, convention, or agreement, or interests in any such copyrighted works, and includes payments from any person for performing rights in any such copyrighted work and payments (other than produced film rents as defined in paragraph (5)(B) received for the use of, or right to use, films. For purposes of this paragraph, the term "shareholder" shall include any person who owns stock within the meaning of section 544.

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